Economic Implications of Post-Disaster Reconstruction

The government intervened with development plans, and accommodative fiscal and monetary policies aimed at higher public spending and increased bank credit flows to counter the impact of the earthquake in the economy.

Background

The devastating earthquakes of April and May 2015 resulted in nearly 9000 deaths and imposed a loss of property worth about NPR 701 billion, or one-third of national output. The burden in the country's fiscal coffers was estimated to be over NPR 950 billion. In the year following the earthquake, 2015-2016, the economy could not expand as the immediate effect slowed down both the public and private sector investments, and lowered job opportunities.

Sectoral Impacts

The impact of earthquake on agriculture was not substantial because rice planting had not begun, and winter crops were already harvested. However, the Post-Disaster Needs Assessment (PDNA)'s estimated

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impact, in terms of loss of output and production on agriculture, was NPR 10 billion. This is because the effect on other factors of production like labour, machinery, seeds, damaged agricultural infrastructure such as the irrigation system and roads, which caused loss of output and productive capacity.

The districts housing core manufacturing corridors were relatively unaffected by the earthquake. There was also a decrease in the demand of the industrial goods, resulting from the energy shortage and instabilities in the supply of fuel and raw materials. Kathmandu valley's industrial sector suffered the most damage. The effect was more pronounced in micro, small and medium enterprises, which neither had sufficient capital cushion to invest, nor had been compensated enough for the loss. A field study done in 2016 revealed that 50 per cent of the surveyed industries were functional within two weeks. However, the recovery period for the businesses to get into normalcy was stated to be between six months to one year.

Furthermore, there was a drag in the service sector, which is an important part of the economy. Tourism was one of the most affected sectors. Since it has backward and forward linkages in areas such as travel, rafting, airline business, money exchange and small tourism business, the impact was echoed across many areas. Gradually, the normalization efforts from private sectors, community and government gained a surge in visitor's arrivals. As things progressed, tourist arrivals also increased. The hotel occupancy rates and service sector witness rebound in growth marching above 5.5 per cent in the FY 2016/17.

The education sector and labour market were the sectors most affected by the earthquake and its aftershocks. It was estimated that 2,472 higher secondary schools, 31,907 primary schools and 413 early childhood development centres were affected by the disaster. Moreover, due to the displacements, mental health issues and lacking access to schools/ education, the existing vulnerabilities were exacerbated. In addition, this was all accompanied by the poor economic situation of the country. As a consequence, the percentage change in enrolment numbers (mostly in the early childhood development centres and primary level) dropped significantly in the following year.

At the labour front, almost 5.6 million workers were affected by the earthquake, impacting livelihoods and reducing incomes compelling earthquake affected families to be dependent on relief and rehabilitation. The earthquake has had a short term as well as long-term implication for the labour market and work. In the short term, the work enthusiasm and opportunities were suppressed by the loss of life, loss of business entities and the loss of means of livelihood. Furthermore, a slower economic growth caused lower demand for labour in the economy. In the long run, the outmigration, the scarcity of labour in agriculture and construction/reconstruction areas, might show in the wage indices.

> The earthquake had significant implication for public finance as it called for increased government expenditure and reduction in domestic revenue

Implications of the earthquake

To counter the impact of the earthquake in the economy, the government intervened with development plans, and accommodative fiscal and monetary policies in the subsequent years aimed at higher public spending and increased bank credit flows. The earthquake had significant implication for public finance as it called for increased government expenditure and reduction in domestic revenue. It also increased domestic and external borrowing and caused substantial alterations to existing investment, and monetary expansions. The government diverted resources away from planned investments in infrastructure and other long-term plans to meet the emergency response.

After two and half years of slow progress, post-earthquake housing reconstruction has picked up speed since late 2017. Moreover, many houses are under construction as beneficiaries and have already received the two instalments of grants. The third tranche can also be expected to make progress accordingly. The total required funds for private housing reconstruction grants given the number of beneficiaries in all the affected districts is approximately NPR 196 billion in three years.

Subsidized loans for rebuilding

The uptake of concessional loan promoted by the central bank was not optimal. The NRB circular directed the financial institutions to provide concessional loan up to NPR 2.5 million inside Kathmandu Valley, and up to NPR 1.5 million in other quake affected districts. It is reported that the financial institutions have issued a mere NPR 1.3 billion to 774 survivors three years since the earthquake, while over 505,000 private houses were fully damaged, and around 279,000 houses were partially damaged, according to the official data. The apparent reason behind the low exhaustion of loans was that the mobilization was exclusively directed towards the individuals with decent income, adequate collateral, and those who can present evidence from the respective local bodies that they don't own any other habitable house. Other technical ambiguity ensued by the grey areas of circular such as penal interest on an overdue loan made financial institutions reluctant on providing loan under this scheme. On top of that, the fixed rate schedule on the low interest rate loan resulted in the dismal level of loan pay-out. Furthermore, financial institutions are not allowed to charge the borrowers of the subsidized loan any amount except the interest and third-party payments.

Foreign funds flow

The initial international response to the Gorkha earthquake was overwhelming. There were pledges and commitments from different governments and multilateral and bilateral organizations. However, net foreign assets and domestic credit did not provide any significant change during the period, which further signalled that there was no substantial spillover to the money system through bank financing and foreign aid, as disbursement in both cases were dismal. There was no significant implication of the earthquake in the monetary sector. Nevertheless, flow of non-monetary aids and massive supply of essential materials to earthquake affected people helped mellow the inflation in the earthquake affected region to some extent.

Similarly, immediately after the earthquake, large Nepali diaspora mobilized support around the globe, many returned home, and many others sprang with quick response. The volume of money sent to Prime Minister's relief account from Nepali individuals, diaspora through Embassies, and Nepali students' associations in universities around the world summed up to approximately NPR 1.6 billion.

Issues and challenges

The challenges are more structural than monetary and fiscal. This is because the country has fiscal cushion to go for deficit financing, a fiscal policy anchored on modest deficit, driven by optimal budget spending to finance a much-needed reconstruction that would not jeopardize the fiscal sustainability. Combined with the monetary space the government could undertake expanded investment in reconstruction related activities. Nevertheless, this is constrained due to structural factors such as prompt and practical decision of the National Reconstruction Authority (NRA), in releasing funds, availability of technical and manual workers, and willingness of the household and public-sector entities to expedite construction. Some of the labour market issues are as follows:

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a) There exists an acute mismatch between job opportunities available in the labour market and the interest or priority of the job seekers.

b) There is a scarcity of labour in agriculture, construction and reconstruction areas while a substantial number of Nepali youth is vying for a low paid foreign employment–which compared with daily wages prevailing in Nepal is lower, particularly in destination countries in the Western Asia.

c) There is no labour market equilibrium even within regions of the country. The earthquake-hit districts are not very far from each other and they are interconnected by reasonably effective transportation and communication. Still there are wage differences across districts prompted by the differentiated condition of labour availability for the same kind of works.

In the monetary front, lower uptake of the bank credit has remained as an unresolved issue. In addition, the slow disbursement of the public reconstruction budget falls on the passive response of line Ministries, and, to some extent, on the Ministry of Federal Affairs and Local Development and Ministry of Urban Development to undertake construction.

In the reconstruction phase, the disbursement of second and third reconstruction tranches were slow. It is important to pace up the approval and disbursal momentum. As the things progresses the government will have to prepare itself by getting skilled and technical human resources required for carpentry, masonry works at the local level, and to ensure thorough supply of construction materials. The major issue confronting the reconstruction work also pertains to slow donor response to the pledged amount, particularly some of the bilateral development partners. The government has not mobilized the pledged fund.

The way forward

The country is recovering from the rubble. However, it needs to realize that an accelerated economic growth by increasing the investment in strategic infrastructures is a necessity. It must also strive to improve basic social services for the people, and put in urgent effort to reconstruct its ancient temples and archaeological treasures damaged by the earthquake.

Nevertheless, the government must be prudent by minimizing the suboptimal level of capital spending. The continuing fiscal surplus owing to inability of spending the budget is not ideal for a low-income country with huge investment needs for reconstruction and infrastructure development.

It is necessary to increase public spending on reconstruction, on physical and social infrastructures, and ensure accelerated employment-centric and inclusive economic growth. On the other hand, in ramping up the budget expenditures, due care should be taken so that the country does not erode the fiscal cushion and exceed the economy's aggregate absorptive capacity. A close policy coordination and information sharing with the regulatory bodies will be significant, so that the fiscal expansion does not lead to overheating and leaves room for necessary private sector credit growth.

Most of the foreign fund pledged for post-earthquake reconstruction has been in the form of loans where more than two-thirds of the spending will go on individual housing construction. Although the social rate of return on housing investment is high, there will not be any immediate economic rate of return on such investment which would enable the state to repay the loan. Thus, a renewed pledge for higher grant in the aid commitment would be necessary to ensure that the country does not fall in future debt crisis. The government should hold another external donor meeting to reassure pledges for necessary resources and appraise them of the progress and challenges in meeting the financing gaps.

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Youth unemployment and labour market mismatch should be reduced by means of (1) imparting required skill for the job opportunities created for reconstruction in the private sector, (2) attractive minimum wage for work, and (3) create employment schemes from the government in public sector. Trade unions should also be invited for constructive feedback and should be a part of the skill re-matching training activities due to their expertise on the subject.

Furthermore, remittances can be an invaluable resource for post-earthquake reconstruction. The fact that, remittances are generally spent on local goods and services, means that their impact is multiplied, providing a further boost to the local community during the recovery and rebuilding process.

Further, the government and the central bank must ease terms and conditions for housing grant. The policy of bank financing at two per cent interest rate and central bank refinancing at zero per cent interest rate was not working because banks were not confident that the scheme would be profitable at such a low rate. A revision in bank lending at 4-5 per cent would not distort the credit market for such financing.

There is a need to involve private consulting and housing construction companies for public sector housing, given the weak capacity of the ministries responsible for housing construction. In addition, there is a need to coordinate with local governments for expediting the reconstruction. ■

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